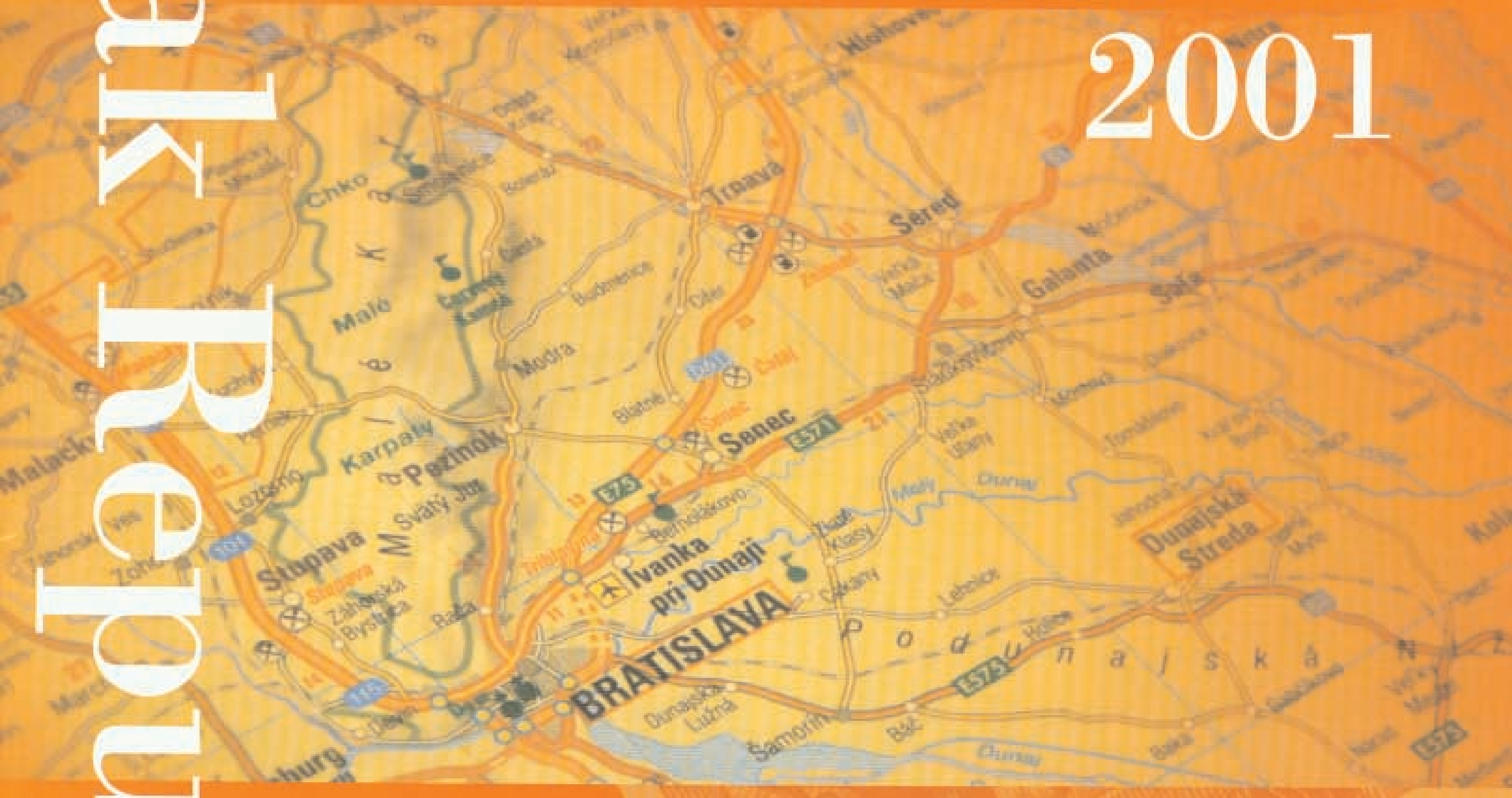
Slovak Republic

BUSINESS FORUM
LONDON 22-24 APRIL 2001

Investment Profile
2001



Held on the occasion of the
EBRD ANNUAL MEETING

Contents

This document was drafted by the EBRD Country Promotion Programme team assisted by Bank staff and the Slovak authorities. It was prepared with information available up to March 2001, derived principally from the EBRD, the EU, Reuters, the EIU and the World Bank. Every effort has been made to ensure accuracy. However, no responsibility is accepted for the contents of this document.
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Introduction

Under the current government elected in 1998, Slovakia has continued to consolidate its democratic institutions and has taken important steps to further economic transition. Economic restructuring and the privatisation of many strategic enterprises have made important progress. The country's international standing has been regained, as reflected in Slovakia's accession to the OECD in 2000. Slovakia also received an upbeat assessment from the EU Commission on its progress in preparing for accession in 2000, and is considered capable of reaching the first group of EU candidates.

Political and economic transition

Slovakia became a sovereign country following the dissolution of Czechoslovakia in January 1993. In the following five years, Slovak political life was dominated by the Movement for a Democratic Slovakia (HZDS), led by Vladimír Mečiar. During this period the restructuring and privatisation process was much slower in Slovakia than in other central European countries. After the election in 1998, a broad coalition government (with the participation of the Slovak Democratic Coalition, the Christian Democratic Movement, the Party of the Democratic Left, the Party for Civic Understanding and the Hungarian Coalition Party) was formed. The current government, led by Mikulás Dzurinda, reversed these developments and reoriented the country towards economic reform. The government revitalised the process of the consolidation of democratic institutions and started to rebuild ties with the international community, including the OECD and other international institutions. Slovakia's accession to the EU and NATO have been the government's priority.

Challenges met and challenges ahead

As a direct result of austerity measures introduced in spring 2000, the country has achieved important progress in reducing macroeconomic imbalances. The general government deficit and the current account deficit have been significantly reduced, but unemployment and overspending on the social security system continue to put serious pressure on fiscal sustainability. High unemployment, 17.9 per cent at the end of 2000, with large regional variations is one of the greatest challenges facing the government. The government intends to ease the situation by introducing measures aimed at reducing disparities in regional labour markets and enhancing labour mobility. Due to the austerity policies, economic growth was relatively modest in the previous two years, but in 2001 it is expected to pick up, reaching 4 per cent, a similar rate to that in other central European countries. (See *Economic summary* below for details.)

FDI inflows to the country have been relatively low, but with the introduction of new policies the situation is likely to change. The government has made attracting foreign direct investment one of its priorities and has approved an extension of its incentive package. Foreign investors' participation in the privatisation process is also being encouraged, based on transparent and predictable rules and regulations. Although the country has been lagging behind its neighbours in terms of privatisation, notable progress has been achieved in the banking and telecommunications sectors and stakes in several large industrial enterprises have been sold as well. (See *Investment climate* below for details.)

The industrial restructuring process has been hampered so far by weak corporate governance and by an ineffective bankruptcy system. However, recent government initiatives in this area, including a new bankruptcy law enacted in August 2000, are likely to bring improvement. The financial situation of many of Slovakia's industrial enterprises has been difficult, and inter-enterprise arrears to the government and the banking sector represent a large burden. Increased foreign investment and progress in privatisation would provide an impetus to finding a solution to these problems.

The restructuring process of the utility sector also gained momentum in 2000. Utility prices have been brought closer to cost recovery levels and most of the cross subsidies have been reduced. Privatisation plans for utility companies (power, gas and the oil pipeline) were approved in 2000, and the implementation will start in 2001-02. (See *Major sectors of the economy* below.)

With regard to the financial sector, the government has proceeded well with the restructuring and privatisation of large banks where the state holds a stake in the last few years. As a result, the banking sector is largely stable and in foreign hands, with the exception of four remaining banks with state ownership that are to be privatised in 2001. In addition, commendable progress has been made in strengthening banking regulation and supervision. However, the Slovak capital markets remain underdeveloped, and liquidity in the stock exchange is still very low. (See *Financial sector* below for details.)

International relations and regional co-operation

Following the political change of 1998, Slovakia's international standing has started to improve dramatically. The country reinforced the orientation of its foreign policy towards the EU and NATO, and started an ambitious programme to secure Slovakia's accession into these organisations at the earliest possible date. In December 2000, Slovakia became a member of the OECD, as the current government had enacted much of the legislation on capital movement, foreign investment and the financial market required of OECD members.

Slovakia has also been contributing actively to regional stability through a policy of good-neighbourly relations and regional co-operation. In terms of regional economic integration, Slovakia is a member of the Central European Free Trade Association (CEFTA), along with Bulgaria, the Czech Republic, Hungary, Poland, Romania and Slovenia. Slovakia also operates a customs union with the Czech Republic. Relations with Hungary, previously tense because of disagreements over a dam on the Danube River and over the treatment of minorities, have also greatly improved.

EU integration

Slovakia started accession negotiations with the EU in March 2000. The invitation to start the talks was received at the Helsinki summit as a response to the democratic consolidation ushered in with the arrival of the new government after the 1998 elections.

In the last few years, Slovakia has made significant progress in terms of meeting the political and economic criteria for EU membership. It is now considered as probably the most advanced among the second round countries (Latvia, Lithuania, Bulgaria and Romania) that started negotiations after the Helsinki summit. In the course of the negotiations Slovakia has provisionally closed 10 chapters out of the total 31 (Fisheries, Common foreign and security policy, External relations, Culture and audio visual policy, Small and medium sized enterprises, Science and research, Education and training, Industrial policy, Statistics, and Consumer and health protection). At the end of 2000 Slovakia submitted to the EU its negotiation positions onthe chapters which are expected to be opened in the course of 2001 (Free movement of goods, Free movement of persons, Company law, Agriculture, Taxation, Economic and monetary union, Social policy and employment, Energy, Regional policy, Environment, Justice and home affairs, Financial control, Financial and budgetary provisions).

EU Progress Report in summary

Progress:

- Legal steps were taken to strengthen the independence of the judiciary.
- Progress in the fight against crime and corruption.
- Faster economic reform.
- Macroeconomic stability has been restored.
- Fiscal discipline has been improved.
- Price distortions are being eliminated.
- Good progress in the restructuring and privatisation of the state-owned banks.

EU Progress Report in summary

Progress yet to be made:

- More efforts are needed to ensure the independence of the judiciary.
- Further reforms are required in the public administration.
- The development of the regions must be stimulated.
- More progress is needed in improving environmental standards.
- Discrimination against the Roma minority must be fought.

Since January 2000 three pre-accession instruments financed by the European Community have become available to assist the applicant countries of central Europe in their pre-accession preparations: the PHARE programme; SAPARD, which provides aid for agricultural and rural development (See *Major sectors of the economy: Agriculture and food processing* below); and ISPA, which finances infrastructure projects in the fields of environment and transport (see *Major sectors of the economy: Transport*). In the years 2000-02, total annual financial assistance to Slovakia will amount to € 70 million for PHARE, € 18.3 million for SAPARD and between € 36.4 million and € 57.2 million for ISPA. The largest allocations of the 2000 PHARE Programme are for SME and export development and an environmental grant scheme.

For the full text of the latest EU Progress Report on Slovakia and other enlargement related information see:

www.europa.eu.int/comm/enlargement/slovakia/index.htm

Information on the PHARE programme is available on the EU Commission's web site:

www.europa.eu.int/comm/enlargement/pas/phare/index.htm


Poland
Czech Republic
Scale 0 10 20 30 40 50 km
to Ostrava
to Katowice
to Kraków
to Rzeszów
to Brno
ŽILINA
Ružomberok
Martin
Poprad
Bardejov
PREŠOV
Humenné
Dubnica
TRENČÍN
Michalovce
KOŠICE
Ukraine
BANSKÁ BYSTRICA
Rožňava
Čierna nad Tisou
to Lviv
Partizánske
ZVOLEN
to Budapest
TRNAVA
R. Hron
NITRA
Lučenec
VIENNA
Sered
Hungary
BRATISLAVA
Austria
Nové Zámky
R. Danube
R. Vah
Komárno
BUDAPEST
This map has been prepared exclusively for the convenience of readers. The denominations used and the boundaries shown on this map do not imply any judgement on the legal status of any territory or any endorsement of such boundaries.
4841 IP01 Slovak Republic map

Economic summary

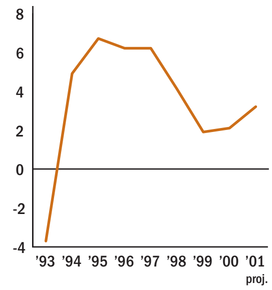
The new Slovak government has taken important steps to reduce macroeconomic imbalances and re-invigorate structural reform. In 2000, important progress was made in this regard: the external current account deficit has narrowed, and important steps have been made towards restructuring and privatising state-owned banks and enterprises. Persistently high unemployment, social security fund overspending and the continuing poor performance of certain industrial sectors are the most important challenges to be addressed. Increased FDI flows from privatisation deals and continuing good trade performance are likely to help Slovakia to narrow its current account and trade balance and also accelerate GDP growth in 2001. A crucial point will be keeping the fiscal deficit under 4 per cent of GDP as requested by the IMF and the World Bank.

GDP growth

GDP growth amounted to an estimated 2.1 per cent in 2000, similar to the 1.9 per cent figure of 1999. The growth was largely generated by an excellent export performance, boosted by strong EU growth and recovery in the CIS, partly offsetting low domestic demand and the impact of macroeconomic tightening and structural reforms.

An acceleration of growth reaching 3.2 per cent of GDP is expected in 2001, largely as a result of the forecasted recovery in domestic consumption. On the other hand, an expected slight slowdown in EU growth will put a limit on the growth of export opportunities and may constrict GDP growth.

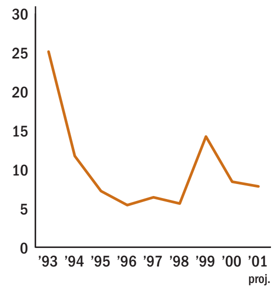
GDP
% change



Inflation

The annual inflation rate has been on an upward trend in recent years and end-year inflation was 8.4 per cent in 2000. A large increase in utility tariffs, depreciation of the currency and strong international oil prices placed significant upward pressure on some prices. However, moderate wage settlements and fiscal consolidation helped the country to fulfil inflation targets. In 2001, inflation will be influenced by opposing forces: although the further liberalisation of administered prices will exert upward pressure, the expected appreciation of the koruna (SKK), the phasing out of the import surcharge and increase in retail competition should provide a counterbalance.

Annual inflation rate
% change

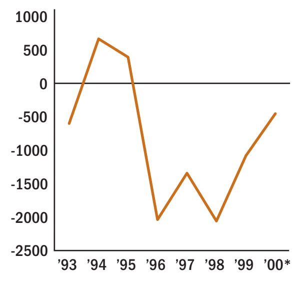


Current account

The current account deficit improved further in 2000, totalling US$ 453.1 million in November 2000, from just over US$ 1,082.9 million in 1999. The main factor behind the considerable shrinking has been an improving performance in terms of international trade and services. In addition to the acceleration of exports, demand for imported goods weakened, thus helping the improvement of the current account deficit. As a result, there has been an important improvement in the trade balance, with the annual trade deficit falling to around US$ 700 million, from US$ 1.1 billion in 1999. The trade balance was negatively affected by high oil prices. Other factors, such as high FDI inflows and income from tourism, also helped the current account balance.

Forecasted EU growth of 3 per cent in 2001 will continue to drive export growth, and will lead to a further improvement in the trade balance. This is likely to result in a narrowing of the current-account deficit.

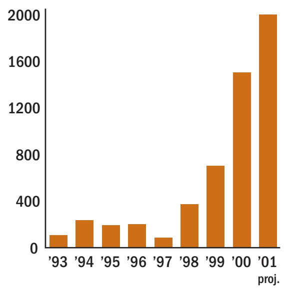
Current account
US$ millions



*November

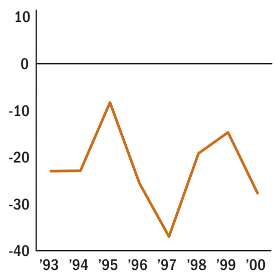
Source: National Bank of Slovakia

Total FDI
US$ millions, cash receipts, net

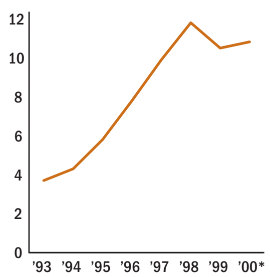


Source: EBRD, January 2001

State budget balance
SKK billion



Gross foreign debt
US$ billion



**November*

Source: National Bank of Slovakia

FDI and privatisation

Given the improving macroeconomic stability, the acceleration of privatisation and several measures taken by the government to improve the investment climate, FDI inflows have grown rapidly, reaching US$ 1.1 billion in 2000, according to the Ministry of Finance. The largest receipts came from big privatisation deals completed in 2000, including the privatisation of Slovak Telekom (ST) and the partial sale of Východoslovenské železiarne (VSŽ), the largest steel mill, and the Slovnaft oil refinery. Last year's performance helped to narrow the gap between Slovakia and its neighbours in terms of its accumulated foreign direct investment stock, which reached US$ 3.6 billion in the 1990-2000 period. Equity capital invested in Slovakia had reached a volume of US$ 2.9 billion by 30 September 2000.

Slovakia's attractiveness to foreign investors is likely to continue in 2001. There are several large privatisations in progress or being scheduled to start, with the biggest deals in the financial and utilities sector. (See *Investment climate* below for details.)

Government balance and external debt

The government budget deficit continued to fall in 2000 from the very high level that prevailed in the mid-1990s. The former government's expansionary policies raised the fiscal deficit to around 5 per cent of GDP in 1998. This trend was successfully reversed by the current government, as the overall general government deficit dropped to around 3.4 per cent in 1999 and slightly increased to about 3.6 per cent in 2000. The budget was inflated by deficit overruns incurred by the social security funds as unemployment stayed high (at 17.9 per cent of the labour force in December 2000), and by high spending on restructuring. The revenue side was lifted by tax reforms that included widening the tax base and bolstering enforcement of payment.

The 2001 budget law sets the central budget at 3.94 per cent of GDP. High unemployment, depressed wage growth that restricts income tax receipts, and commitments for increased infrastructure spending will all put strong pressure on the planned budget. Reforms of the healthcare, pension and education systems will be crucial in keeping the fiscal deficit on target in the coming years.

Exchange rate

In 1998, the Slovak government abandoned the currency peg, since when the koruna (SKK) has been freely floating. The National Bank of Slovakia (NBS) occasionally intervenes in the market to guard against excessive real appreciation and depreciation. The annual average exchange rate of the koruna against the US dollar was SKK 46.2 in 2000, as opposed to SKK 41.4 in 1999. It is predicted that the koruna will undergo a sizeable real appreciation against the currencies of Slovakia's main EU trading partners in 2001, owing to large FDI inflows to fund privatisation purchases by foreign investors. The NBS will increasingly face the challenge of adequately sterilising privatisation receipts in order to maintain a competitive exchange rate. However, the currency is likely to weaken in the run-up to the parliamentary election due to be held in 2002.

IMF recommendations and Country Assistance Strategy

In July 2000, the IMF released a Staff Report for the 2000 Article IV Consultation on Slovakia, which outlined its views on the country's economic development. The report stresses the need to tighten fiscal policy, reduce the current account deficit, and deal with weak financial discipline and performance in the state banking and enterprise sectors. It also stressed the importance of attacking structural weaknesses in the budget, including the high tax burden and the high level of government spending relative to GDP. Also in the fiscal area, the Fund encouraged the authorities to strengthen their control over the operations of the general government outside the state budget. In addition, the report emphasised that rapid implementation of a comprehensive bank restructuring programme, including the privatisation of state-owned banks, should be given high priority, and urged the authorities to accelerate and complete enterprise privatisation. In February 2001 the World Bank approved the Country Assistance Strategy for Slovakia, under which a loan is expected to be provided in the amount of US$ 415-765 million.

EU convergence issues

The latest annual EU Progress Report on Slovakia praised the country for its progress on establishing macroeconomic stability through measures to reduce fiscal and external deficits. Slovakia has been regarded as a functioning market economy that should be able to cope with competitive pressure and market forces within the Union. The report also praised the government for starting the privatisation of public utilities and for steps taken to eliminate price distortions. Concerning the challenges facing the country, the EU called for the completion of ongoing structural reforms, both in the enterprise sector and in public finances, and the strengthening of banking supervision.

Credit ratings

Standard & Poor's sovereign ratings, January 2001

Local Currency			Foreign currency		
Long-term	Outlook	Short-term	Long-term	Outlook	Short-term
BBB+	Positive	A-2	BB+	Positive	B

Moody's country ceilings for foreign currency ratings, January 2001

Bonds and notes		Bank deposits	
Long-term	Short-term	Long-term	Short-term
Ba1	NP	Ba2	NP

Fitch IBCA foreign currency sovereign ratings, February 2001

Long term	Short term
B	BBB+

Selected economic indicators

	1993	1994	1995	1996	1997	1998	1999	2000	2001 pro.
GDP (% change)	-3.7[a]	4.9	6.7	6.2	6.2	4.1	1.9	2.1	3.2
Annual inflation rate, %	25.1	11.7	7.2	5.4	6.4	5.6	14.2	8.4	7.8
Current account (in US$ millions)	-601	664.9	391.4	-2,038.1	-1,343.1	-2,059.2	-1,082.9	-453.1[b]	na
State budget balance (SKK billion)	-23.0	-22.9	-8.3	-25.6	-37.0	-19.2	-14.7	-27.7	na
Trade balance (in US$ millions)[c]	-932	58.5	-227.5	-2,292.6	-1,471.8	-2,292.5	-1,103.1	-689.5[b]	na
Foreign direct investment (in US$ millions, cash receipts, net)[d]	107	236	194	199	84	374	701	1,500	2,000
Gross foreign debt (US$ billion)	3.7	4.3	5.8	7.8	9.9	11.8	10.5	10.82[b]	na
Unemployment[e]	14.4	14.86	13.1	12.8	12.5	15.6	19.2	17.9	na
Exchange rate SKK per US$	3.2	31.3	29.6	31.9	34.8	36.9	42.27	47.389	na
Gross reserves, excluding gold (end-year, US$ millions)[d]	395	1,605	3,306	3,403	3,204	2,867	3,366	4,886	6,609

a This figure is based on GDP volumes according to ESA 79. The figures for years 1994-2000 are based on GDP volumes according to ESA 95.
b November
c For 1993-95 including import of private sector
d EBRD figures
e Starting with 1997 the data is based on disposable number of registered unemployed persons.
Source: National Bank of Slovakia

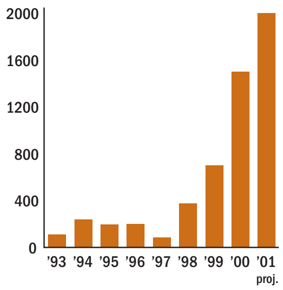
Investment climate

In 2000, FDI inflows to Slovakia increased significantly as a direct result of entering upon further liberalisation and openness, and thanks to an improved economic climate. The government has implemented a serious set of measures to encourage foreign capital inflows, including further strengthening incentives, and has given important impetus to the privatisation process. These new measures, combined with the country's favourable location, skilled labour force and low labour costs, will greatly help Slovakia to catch up with its neighbours in terms of FDI levels.

Foreign direct investment

In the last few years, an increasingly appealing environment for investors has been created in Slovakia, as a result the country is catching up with its neighbours in terms of FDI inflows. In the January-September 2000 period, net FDI inflows of US$ 1 billion were registered, double the figure for 1998, previously the most successful year.

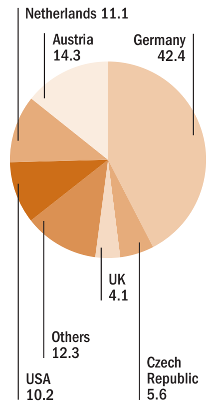
Total FDI
US$ millions, cash receipts, net



Source: EBRD, January 2001

The Slovak government, which favours FDI and EU membership, adopted its Strategy for the Support of Foreign Direct Investment Inflow in 1999. This strategy sets out the measures being taken to increase the level of FDI in Slovakia. The policies employed are strengthening investment incentives, establishing industrial parks, getting privatisation started, especially in the financial and energy sectors, as well as liberalising the general legislative environment for foreign investors (such as reducing corporate income tax). The investment climate has also been largely improved by Slovakia's entry to the OECD in autumn 2000. The accession criteria required the government to undertake wide-ranging liberalisation measures, especially in the financial sector.

Structure of FDI by country of origin
as at September 2000, per cent



Source: SARIO

In 2000, around half of all investment was in the manufacturing sector, within which automotive components, consumer electronics and precision engineering represented the lion's share. Further important sectors for FDI are financial services and trade, followed by real estate and communications. A large part of the foreign investment was related to the privatisation of state assets. (See *Privatisation* below.)

In geographic terms, as at 30 September 2000 69.8 per cent of all investments were placed in the Bratislava region. However, as confidence in Slovakia grows, foreign investors have increasingly started to settle in regions outside the capital, such as the east Slovakian regions of Prešov and Košice, which offer more space and a larger supply of cheap, qualified workers.

Investment policy and incentives

As of 1 January 2001, the following investment incentives have been applicable in Slovakia:

- A five-year corporate tax break is available to companies which are 60 per cent foreign-owned, and invest at least € 4.5 million.
- The investment threshold falls to € 3 million for companies investing in regions with an unemployment rate over 10 per cent and to € 2 million for selected services, such as tourism and information technology-related investments.
- 50 per cent corporate tax relief for the subsequent five years is available to companies that invest a further € 4.5 million, or € 3 million in districts where unemployment is higher than 10 per cent.
- Zero tariffs are applicable on imports of new machinery and equipment for manufacturing.
- Investors will also receive a state contribution of SKK 30,000-160,000 (€ 680-3,600) for every job created.

In the second part of 2000, the government also launched preparations for the creation of a number of industrial zones, as well as for the establishment of a special fund for their development. Support from the fund will be given to towns and villages and may be used to finance the purchase of land, technical and transport infrastructure, land alterations and environmental improvements.

An important development is the new Bankruptcy Law, passed by the Parliament in June 2000, which has largely improved the legal framework for industrial development and should create the conditions for more effective enterprise restructuring. The law strengthens the position of creditors in bankruptcy cases and allows them to participate in the restructuring of the bankrupt company. Key changes include setting an 18-month period for the completion of bankruptcy proceedings, simplifying the rules regarding the creditors' entitlement to debt collection, allowing creditors to change the bankrupt company's trustee, and allowing the trustee to sell the property of the bankrupt firm.

Regarding capital movements and payments, Slovakia has been applying a gradual approach to liberalisation, focusing first on long-term capital inflows and FDI. The Slovak Foreign Exchange Act, which regulates this domain, has been liberalised in several respects. Acquisition of real estate was liberalised from January 2001 for branches of foreign entities from EU and OECD member countries, provided that the real estate is needed for the performance of their business activity. As regards trade in securities, as of January 2000 residents are no longer required to obtain a Foreign Exchange permit to acquire foreign securities traded in the main market of foreign stock exchanges. The permit requirement was also dropped for residents issuing Slovak securities abroad, provided that the securities have a maturity period of at least one year. Other such securities still require approval. As of 1 January 2001 financial credits and loans and provisions of guarantees were liberalised.

In an attempt to fight money laundering, a new law effective from 1 January 2001 requires banks, branches of foreign banks and a broad range of other financial entities to identify the author of any transaction. The new law also requires cases where such transactions appear suspicious to be reported to the police.

Privatisation

In 2000, the government took significant steps towards privatising state-owned companies and financial institutions. The most notable progress was in the banking sector, where full privatisation of two banks with state holdings (Všeobecná úverová banka (VUB), and Investičná a rozvojová banka (IRB)) is firmly on track. SLSP was sold to Erste Bank (Austria), the privatisation process for IRB is currently under evaluation and VUB's privatisation will be launched in the first quarter of 2001. The government also announced its intention to sell its stake in Slovenská poist'ovňa, the largest Slovak insurer. (See *Financial sector* below.)

In the largest privatisation to date, a 51 per cent stake in Slovak Telekom (ST) was sold to Deutsche Telecom (DT) in July 2000. Important developments took place in the manufacturing sector as well, as US Steel bought into VSŽ, the country's largest steel-maker, and Hungarian oil and gas company MOL acquired one-third of oil refinery Slovnaft, the dominant player in the Slovak oil and gas market. (See *Major sectors of the economy* below.)

Legislation that entered into force in October 1999 allows for privatisation of up to 49 per cent of most public utilities in the energy and transport sectors. The government is committed to the process and has taken preliminary steps regarding the oil company Transpetrol and the gas company SPP.

Slovak Investment and Trade Development Agency (SARIO)

SARIO is a full service investment promotion agency addressing the needs of foreign investors and assisting Slovak enterprises to identify suitable foreign partners.

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E-mail: ***sario@sario.sk***
Web site: ***www.sario.sk or www.investinslovakia.com***

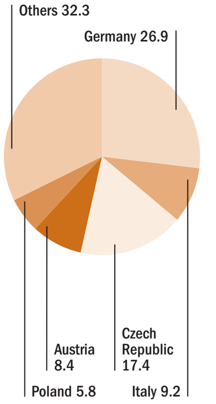
Taxation and social expenditure

The Slovak system of direct tax includes corporate and individual income tax and property tax. The indirect tax category comprises excise taxes and value-added tax. As a major step towards improving the tax environment, the government reduced the corporate income tax to 29 per cent from the previous rate of 40 per cent with effect from 1 January 2000. The new rate is comparable to Slovakia's neighbours (Poland: 30 per cent, Czech Republic: 31 per cent) and also close to the EU average. The 1999 tax reform that brought in improvements in the tax deductibility of expenses, losses carried forward and depreciation rules also created a more favourable environment for investors.

Income tax rates for seven income categories range from 12 to 42 per cent. Excise tax is imposed on the following goods produced in or imported to Slovakia: beer, wine, spirits, tobacco, carbohydrate fuels and lubricants. The general rate of value-added-tax is 23 per cent, with a special rate of 10 per cent for specific goods and services such as staple foods, energy and others.

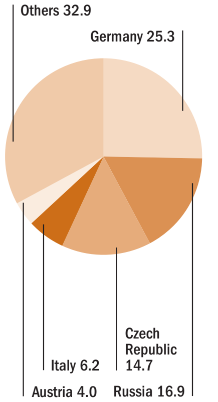
A generous social safety net represents a big burden on state finances and is in urgent need of reform. High unemployment is one reason for the increased social welfare system deficit. Another factor is the size of social security payment arrears in the enterprise sector. The government plans to add a private pillar to the current pay-as-you-go pension system from 2002.

Leading Slovak export trade partners
January-November 2000, per cent



Source: Slovak Statistical Office

Leading Slovak import trade partners
January-November 2000, per cent



Source: Slovak Statistical Office

Markets and trade

Slovakia is a member of the WTO and is bound by the GATT Agreement on Implementation of Article VII. Customs valuation is based on this agreement and the rules appear to provide a uniform and neutral system of valuation. Slovakia's applied tariffs currently average 6.4 per cent on all products, 14 per cent on agricultural products, 0.1 per cent on fishery products and 4.9 per cent on industrial products. Documentation requirements are harmonised with EU standards. After the GATT Uruguay Round, Slovakia reduced tariffs to 3.8 per cent. The average tariff reached 1.03 per cent and 0.75 per cent in 1998 and in 1999 respectively. Since then trade in industrial products is free of tariffs and imported machinery, equipment, apparatus and instruments are exempt from customs duty under specified conditions.

With a substantial improvement in the trade balance, Slovakia removed its 3 per cent import surcharge from 1 January 2001. An import surcharge of 7 per cent was introduced in June 1999 as part of the government's austerity package.

Slovakia is in the process of adopting the EU's external trade regime. The country's trade is heavily oriented towards the EU member states (59.3 per cent of total exports and 49.3 per cent of total imports). The two sides are lowering and eliminating tariffs on an increasing number of industrial products under the agreement. Upon accession, full alignment with the EU's Common External Tariff (CET) will be required. In July 2000, Slovakia started to work on the harmonisation of legislation in the area of export credits.

The Czech Republic is an important trade partner, as the two countries are part of a customs union and pursue a common trade policy. Slovakia is a member of CEFTA (Central European Free Trade Agreement), holds a trade agreement with EFTA (European Free Trade Association) and free trade agreements with Estonia, Latvia, Lithuania, Turkey and Israel.

Major sectors of the economy

In 2000, Slovakia has progressed with the privatisation and restructuring of several strategic enterprises. Slovnaft, a large oil refinery, was sold to MOL (Hungary's largest oil company); Slovak Telekom, monopoly fixed lines provider, was sold to Deutsche Telecom; and VSŽ, large steel making conglomerate, was sold to US Steel. However, there are still many important companies in need of restructuring and change of ownership, particularly in the energy sector.

Telecommunications

The Slovak telecommunications market has advanced rapidly during the last few years. In 2000, the government continued the liberalisation process by adopting the Telecommunications Act. The new law creates the conditions for liberalisation, by abolishing the monopoly in the provision of fixed-line local, domestic long distance and international long distance services by January 2003. It also specifies the rules for interconnection charges, establishes an independent regulator and aligns the sector with EU directives. In addition, the government has commenced the process of tariff adjustment, whereby local tariffs are increased to compensate for a reduction in domestic and international long distance tariffs, bringing prices more in line with those in the European Union member states.

As the largest Slovak privatisation to date, a 51 per cent stake in Slovak Telekom (ST) was sold to Deutsche Telecom AG (DT) in July 2000. ST, the dominant player of the telecoms market, has a monopoly in fixed-line operations until 2003 with 1.6 million connections and also owns a majority stake in the mobile operator Eurotel. DT purchased a 51 per cent stake in ST for € 1 billion. Planned investments in ST will focus on increasing fixed-line penetrations from the current 30 per cent level to 45 per cent by the end of 2004.

There has been a strong growth registered in data communications and internet services in the last few years. Several foreign telecom companies, Telenor (Norway), KPN (Netherlands) and UPC (Netherlands) made investment in this less regulated sector. These firms view internet and cable operations as an opportunity to establish themselves as providers of a complex range of telecommunications services before they enter the Slovak telephone market.

Mobile telephony

The mobile phone sector has become the most dynamic growth sector in the telecommunications market over the last few years. There are two licensed service providers: Globtel and EuroTel. The sector is well-developed and highly competitive, as both companies are affiliated with well-established foreign telecom companies and mobile telephony operators with significant financial and marketing resources. France Telecom holds a 64 per cent stake in Globtel, the largest operator. The government intends to sell its 36 per cent stake in Globtel in 2001.

EuroTel is a subsidiary of Slovak Telecom, now 51 per cent owned by Deutsche Telecom, and Atlantic West, a joint venture owned by BAC International (US) and MediaOne International (US). A third operator is expected to appear on the Slovak telecom market with commercial services starting not earlier than 2003. Its entry to the market is planned in conjunction with the award of UMTS licences, which is expected to happen in the first half of 2002.

Automotive

The automotive industry, and specifically the automotive component market, is one of the fastest developing sectors in Slovakia. The growth of the industry accelerated from an annual 25-30 per cent in the mid-1990s to rates of over 50 per cent at the end of the decade. The sector's foreign investors expect growth to continue and assume a 41 per cent expansion in 2000, compared with the expectation of 10 per cent growth among foreign investors as a whole. The sector currently employs about 18,000 people and represents about 4 per cent of the country's entire production capacity.

The country's only car producer, Volkswagen (VW), is one of the largest foreign investors and acts as a driving force for the whole sector. VW's continued expansion is having a very strong knock-on effect on the growth of production. Around half of the automotive components produced in Slovakia are now shipped to companies belonging to the VW group. An interesting feature of the industry is its high level of regionalisation, as the majority of parts makers supply assembly plants located primarily in the Czech Republic and also in Poland. Areas in which Slovak companies are particularly strong include: pressed parts, welded metal sub-assemblies, castings, forging and machining in iron, steel and other non-ferrous materials.

Volkswagen

Europe's largest car manufacturer, VW, is the dominant player in the Slovak automotive industry. With SKK 69 billion sales in

Slovakia in 1999, the company alone accounted for more than 55 per cent of the Slovak automotive sector's revenues. VW's emergence as the largest company in Slovakia marks a positive shift from the production of semi-finished goods to more valuable finished products.

VW's growth in Slovakia started in 1991, when it acquired the local utility producer BAZ as a component-maker for its newly acquired Skoda plant in the Czech Republic. As a next step, the company brought low-volume assembly of labour intensive, specialist versions of the Golf hatchback and Passat BV to Bratislava in 1992. The rapid explosion of VW's operation came in 1998, when it started a DM 450 million investment in the Bratislava plant, doubling the capacity to between 250,000 and 300,000 units per year. Polo production gradually transferred to the plant from Wolfsburg (Germany) in 1999, making Bratislava the second biggest Polo production site after Pamplona (Spain). VW also plans to start with the assembly of the off-road Colorado in Bratislava in 2002, adding another 80,000 units a year with a DM 400 million investment. In 2000, VW started to spread its facilities into the countryside in order to ease problems with recruiting enough workers in the Bratislava region. The company transferred axle and transmission production from Bratislava to Martin, central Slovakia, a city that was badly hit by the collapse of the defence industry in the 1990s. The factory, which will receive DM 40 million investment when fully completed, will produce 2 million components, gearboxes, axles and steering wheels annually and employ 450 people.

VW is also involved with the local authorities in setting up a business zone on a 32-hectare site only 10 kilometres from the company's current plant in Bratislava. It plans to invest US$ 81.3 million in the site and create 1,000 new jobs by 2002. Some of the company's international suppliers are likely to set up facilities in the zone, with the car-seat producer Johnson Controls (US) expected to become the site's first occupant.

Leading component makers

Company	Country of origin	Major product	Revenue (1999, € million)
ZSNP	Slovakia	Car discs	310
Matador	Slovakia	Tyres	290
Johnson Controls	US	Car seats	81
VW Electrické systémy	Slovakia/Germany	Cable harnesses	na
Sachs (Mannesman)	Germany	Transmissions	37
Siemens Automotive	Germany	Cable harnesses	na
KLF-ZVL	Slovakia	Bearings	35

Source: EIU

The largest component producer by revenue is ZSNP. Although the ZSNP aluminium works concentrates on processing primary aluminium, it has been rapidly expanding into the car-parts business. The company produces aluminium car discs and gearbox casts for the VW concern and opened a new plant for the production of cylinder heads in 2000. The plant will supply VW and Daewoo (South Korea) plants in Poland.

German electromechanical giant Siemens has two large facilities that are related to the automotive sector. Its joint venture with VW, Volkswagen Elektrické Systémy, produces cable harnesses in Nitra, western Slovakia, for the whole VW group. Siemens Automotive, located in Michalovce, eastern Slovakia, produces 70 types of wiring harnesses for Ford, Honda, and VW passenger vehicles.

A strong regional player is tyre manufacturer Matador (Slovakia), which has a joint venture with Continental (Germany), the world's fourth largest tyre producer. Matador has been investing heavily in product development and in 2000 secured a contract to supply 400,000 tyres to Škoda (Czech Republic). Matador also has a joint venture in Omsk in Siberia where it produced 850,000 tyres for Avtovaz Togliatti.

The growth potential of the sector was shown by the arrival of new important companies in 2000. One example is the US-based Dana Corporation, one of the world's leading suppliers for the automotive industry, which operates 300 facilities in 32 countries. Dana Corporation purchased a majority stake in Slovak engine bearing manufacturer Tribometal Dolný Kubín in March 2000. Tribometal currently produces 60 per cent of its goods for export to countries including Italy, Germany and the US, and is also a main supplier of bearings for Volkswagen in Slovakia and Škoda in the Czech Republic.

Metallurgy

The traditionally strong metallurgical industry represents around one seventh of industrial production and 9 per cent of employment. It also has an important role in foreign trade, as it constitutes 16 per cent of total exports from Slovakia. In the last few years, there have been some successful restructuring programmes in the industry directed towards the re-organisation of production facilities with progressive characteristics and the development of production fields with higher added value. Foreign strategic and financial investors including the EBRD, Hydro Aluminium (Norway), US Steel, and Rautaruukki (Finland) have been playing an active role in the development of the industry for several years. Aluminium producer Slovalco (see case study below) and leading steel-maker VSŽ illustrate the strength and investment potential of Slovak metallurgy.

VSŽ, the country's largest steel-maker, received an important boost in 2000 through US Steel's acquisition of its steel making facilities. VSŽ accounts for 8 per cent of GDP, plays a vital role in the economy of Košice, the second largest city, and is acclaimed as eastern Europe's highest quality steel producer. The company underwent a successful restructuring programme in 1999, after it defaulted on its foreign debt in late 1998, and was brought back to almost full capacity by 2000. US Steel is taking over VSŽ's core steel-production activities, while a separate unit concentrating on other activities will remain in the hands of the current stakeholders. The American firm paid US$ 60 million at the time of the deal and assumed some US$ 325 million in debts and another US$ 15 million in tax arrears. The new acquisition is US Steel's first fully owned foreign steel operation and is intended to become a base to satisfy increasing demands in eastern Europe for steel-sensitive products such as cars and appliances. The American firm has announced plans to invest up to US$ 700 million in the factory, aiming to expand its existing tin-plate joint venture and build a 330,000-tonne galvanising line for automotive-grade steel.

Case study: Slovalco aluminium smelter

Aluminium smelter Slovalco is one of the most successful and profitable Slovak industrial companies and throughout its development it has received active support from the EBRD. Slovalco was established in 1993 by Slovakia's ZNSP a.s., the state-owned aluminium producer, with the subsequent equity participation of Hydro Aluminium, a light metal subsidiary of Norsk Hydro of Norway, and the EBRD. Currently, ZSNP Group owns 75.5 per cent of Slovalco, followed by Hydro Aluminium with a 14.5 per cent stake and the EBRD with a 10 per cent stake.

Along with Norsk Hydro, the EBRD entered the company through a US$ 15 million equity investment in 1994. It also provided at that time a US$ 110 million loan that was refinanced in 1998 by the EBRD and a syndicate of private banks. The EBRD has had an ongoing commitment to Slovalco ever since. The EBRD, Norsk Hydro, and the management of the company are working together closely to ensure the continued success of operations and also to assist in securing financing for further development plans.

The project was the first rehabilitation and privatisation of a former large industrial enterprise carried out by the EBRD and is considered one of the EBRD's best projects to date. The EBRD's participation was of crucial importance, as projects to restructure large-scale formerly state-owned enterprises generally have difficulty in gaining access to commercial sources of financing.

The EBRD investment has had transition impact in a variety of ways, such as industrial reconstruction, transparency and shareholder participation, and environmental rehabilitation. Both directly and indirectly, by facilitating the entry of a foreign investor, the project helped Slovalco to achieve a successful privatisation and rehabilitation, and turn itself from an inefficient enterprise into a modernised and prosperous one. The investment also enabled Slovalco to replace its polluting smelters with a world-class energy-efficient alternative, fitted with the best available pollution control equipment. As a consequence, significant environmental, health and safety improvements were registered in the region.

Finally, the successful operation of Slovalco has had wider economic benefits as well. Acting as a high quality and reliable supplier, Slovalco has encouraged the development of automotive component investments, serving producers like Škoda and Volkswagen in Slovakia.

Slovalco has reported excellent results for the past few years. It tripled its profits in 2000, reporting full-year unaudited net profit of US$ 24.2 million, against US$ 10.5 million in 1999. Sales reached US$ 265 million, against US$ 239 million in 1999. According to Slovalco's management, these positive results are due to modern technology with low consumption of raw materials and energy, purchases and sales based on long-term contracts, and investments aiming at the growth of productivity.

In 2001, Slovalco plans to start major expansion projects to increase the number of its smelters. The investment will cost about US$ 80 million and the new capacities will increase production by one third.

Energy

Following several years of very little market reform, in 2000 the government took decisive steps, including introducing price adjustments, starting partial privatisation and drafting a liberalisation plan for the sector.

Around 80 per cent of Slovakia's energy sources are covered by imports, Russia being the most dominant supplier. The country received a large share of its imports below market prices for a long period due to bilateral agreements with Russia, which resulted in low energy prices and also a low level of energy sector efficiency. Following several years of little or no price adjustments, the government sharply increased utility prices in 2000. Household electricity prices increased cumulatively by 135 per cent, heating prices increased by 112 per cent and rents increased by 70 per cent. However, as local energy prices are still well below cost-recovery levels, further substantial increases are necessary before EU accession and energy market liberalisation.

The government is currently debating the reform of the energy sector, which would include the restructuring of existing companies, privatisation to strategic investors and the establishment of an independent regulatory body. In September 2000, the cabinet approved the draft project for transformation and partial privatisation. The privatisation project proposes selling 49 per cent stakes in the power companies, gas company SPP, and oil pipeline operator Transpetrol by the end of 2001. The gradual full liberalisation of the market is planned only following the privatisation, although no firm timetable for this has been agreed. Liberalisation will be an important issue during EU accession negotiations. The sector's regulatory body is expected to be established in the first half of 2001. The main role of the body will be to oversee privatisation and to establish a price-setting mechanism that protects energy prices from political manipulation. The apolitical and independent functioning of the body would greatly ensure foreign and domestic investors intending to enter the market.

According to the latest report of the EU Commission, Slovakia needs to enhance its efforts to be in a position to comply with the energy *acquis* in the medium term. Particular attention should be given to emergency oil stocks, the further liberalisation of the internal energy market, the removal of price distortions and the further improvement of energy efficiency.

The government reached a decision in September 2000 on the sale of 49 per cent share of Slovenské elektrárne (SE), the state-owned power utility. According to the power sector restructuring plan, the national grid will be separated from SE and will remain state owned. SE is scheduled to be privatised by the end of 2001. The government will make a decision on the proposal for the restructuring and privatisation of SE in the first half of 2001.

Slovakia has two nuclear power stations, one at Jaslovské Bohunice and another at Mochovce, representing almost half of electricity production. Mochovce's management is jointly run by the Eukom consortium (50 per cent), made up of Framatom (France), Siemens (Germany), and Škoda Plzeň (30.2 per cent, Czech Republic), with the participation of Russian and local companies. Completion of two more reactors at Mochovce over the next decade is being considered and foreign investors are likely to be offered opportunities related to the project.

At the same time, the government has decided to decommission the first and second reactors at Jaslovské Bohunice by 2006 and 2008 respectively. The cost of decommissioning is assessed at SKK 16 billion (US$ 372 million) and is to be partially covered by the International Nuclear Decommissioning Fund, which operates with the participation of the EU and the EBRD.

Oil and gas

The Slovak oil and gas industry strengthened its regional character in 2000, as Hungarian gas and oil company MOL became a strategic investor in oil refinery Slovnaft, and Russian gas monopoly Gazprom started negotiations on building a gas pipeline that connects to the west through Slovakia.

As part of the energy restructuring and privatisation plan, the authorities agreed to privatise minority stakes in gas monopoly SPP by the end of 2001, which has yet to be turned into a joint-stock company before privatisation. A recent estimate values SPP at US$ 7 billion. The government is also expecting to strike an agreement soon over the privatisation of Transpetrol, the oil transportation firm. At issue is the size of the stake to be put on sale; the state must retain a majority, and is considering selling either a 34 per cent or a 49 per cent share of the company.

Slovakia is a strategic transit country for Russian gas, both for western Europe and the immediate region. The capital structure of the pipeline system had in the past been greatly under-leveraged, and SPP has obtained significant financing from the European Investment Bank (EIB) and other western lending institutions to widen and upgrade links to the Austrian and Czech borders. In March 2000, Gazprom turned to Poland and Slovakia to build a pipeline on their territories, through which Gazprom could transport higher volumes of gas to western Europe. The new pipeline should enable Gazprom to diversify its gas transport routes.

Slovnaft

In April 2000, Hungarian oil and gas company MOL acquired one-third of oil refinery Slovnaft, including the right to increase its stake to above 50 per cent after two years. This is the largest single foreign investment in the country to date, as well as the biggest cross-border deal in the region. MOL paid US$ 262 million for the share and will use US$ 150 million of this amount to raise the company's basic capital.

Slovnaft owns one of the largest oil refinery facilities in the country and is the dominant player in the gasoline retail market. Its refinery has a capacity of 330,000 barrels per day. Currently, Slovnaft is in the process of upgrading its refinery. The US$ 526 million project will increase the production of petrol and fuel, making Slovnaft one of the most modern oil refineries in Europe. All the crude oil processed by Slovnaft is bought from Russia. In 1999, exports were responsible for about two-thirds of sales. The biggest portion of export, around 42.2 per cent, was destined for the Czech Republic, while Austria (20.5 per cent) was the second most important destination, followed by Hungary with 9 per cent.

Slovnaft controls around 40 per cent of the fuel distribution market with a 319-strong chain of Slovnaft and Benzinol gasoline stations. It also has more than 40 stations in the Czech Republic. MOL's share on the Hungarian retail market is 36 per cent and 3 per cent in Romania. In connection with the deal, the Slovak Competition Office has ordered the company not to expand its Slovak gasoline retail chain in the next four years, in order to avoid the further increase of Slovnaft's already considerable dominance in the domestic distribution market.

Slovnaft was privatised in two stages in the early 1990s through a management buyout. The National Property Fund has a 7.98 per cent share, while the EBRD owns 8.37 per cent of the shares.

Wood processing, paper and pulp

The areas of forest covering more than 40 per cent of the Slovak territory represent a great raw material basis for the wood-processing and paper and pulp industries, which have traditionally been an important part of Slovakia's economic life.

In the paper and pulp industry, important modernisation and ecological projects have been realised at several production plants, resulting in increased production levels in the last few years. Revenue rose almost twofold between 1994 and 1999, with export shares consistently over 60 per cent. Major customers are mostly from nearby countries, especially the Czech Republic, Austria and Germany. The industry has serious growth potential as the raw material basis represented by wood paste and waste paper has been steadily increasing. Foreign investors have gained ownership, partial as well as full, of several paper manufacturers in the last few years. In spring 2000, Neusiedler, the Austrian unit of Mondi (South Africa), acquired 50 per cent of SCP Ruzomberok, the country's largest paper mill. Neusiedler pledged to invest US$ 110 million in the next four years.

Following the slowdown of production in the mid-1990s, in recent years growth of the sector has accelerated. It is estimated that furniture output would grow further in 2001. The most successful company is Swedwood Slovakia, which belongs to the Swedish concern IKEA. The company makes its products chiefly from inputs from Slovak producers and exports 99 per cent of final products within the IKEA sales network. In summer 2000, in addition to its two facilities in Malacky, Swedwood finished the complex reconstruction and modernisation of two new factories, Spartan in Trnava for the production of cabinet furniture, and Jasná in Závažná Poruba, designed to produce wooden furniture. In another major investment, Danish furniture company Lind Mobler Bramming has constructed a new plant for upholstered furniture production in Krupina. Production began in April 2000, following an investment of SKK 85 million. A second production hall will come into operation by the end of 2001. A large number of small private wood-processing companies, particularly furniture producers, have also sprung up in the last few years because of the associated low labour and investment costs. Some of these companies export their goods, principally to EU countries, as well as producing for the domestic market.

The EBRD also supported the development of the Slovak wood processing industry, through a DEM 28.5 million loan provided to wood-processing company Bučina Zvolen a.s. in 1998 to modernise its production facilities, double capacity for particleboard and upgrade the company's energy systems.

Agriculture and food processing

Slovakia is self-sufficient in major agricultural products such as cereals, sugar beet, oilseeds, potatoes, beef, meat and milk. The share of agriculture in GDP and in employment has been on a downward trend for the past few years. It currently accounts for 4.5 per cent of the GDP and 7.4 per cent of total employment. As a result of a serious drought, production further dropped in 2000, when the country had the lowest harvest for the last 50 years, and yields were down 30-50 per cent in comparison with previous years.

The privatisation and restructuring of the sector involved the break-up of the majority of state farms, the transformation of co-operative farms into new types of business entities, and the appearance of small-scale private farmers. Currently, the transformed agricultural co-operatives manage 69 per cent, while private farms make up about 9 per cent of total arable land.

Slovakia's most important agricultural trade partner is the EU, with oil seeds, animal fodder and dairy products being the largest export product groups. Negotiations on bilateral trade concessions with the EU were concluded in May 2000. As a consequence of the new agreement approximately two thirds of EU imports and 40 per cent of EU exports of agricultural products will be exempted from duties. Starting from 2001, Slovakia will receive grants from SAPARD, the EU's pre-accession agricultural fund. The programme is based on the following priorities: improvement of the agricultural production sector, including the food industry, through supporting investments in farm holdings and investments aimed at contributing to the upgrade of agri-food enterprises to EC standards, and increasing their competitiveness; support to sustainable rural development with a view to increased job opportunities and development of ecologically sound management of natural resources. The budgeted funds for 2001 will amount to SKK 239.6 million (€ 5.4 million), and for 2002 the expected amount is SKK 365 million (€ 8.2 million).

Slovakia has embarked on a series of changes in policies and regulations in preparation for EU accession. In the opinion of the EU, significant progress has been achieved in recent years. However, there is a need for accelerated alignment and implementation as well as strengthening of administrative capacities in all areas. The most important objectives are: the completion of the market information system, the creation of the central animal register, strengthening implementation of veterinary and phytosanitary standards and the introduction of agro-environmental schemes in forestry.

Food industry

The food industry is one of the largest industrial sectors, accounting for around 15 per cent of total industrial output. Privatisation of the sector has recently been completed and since the mid-1990s there has been a growing inflow of foreign direct investment.

The highest foreign participation is in the sugar sub-sector, where all the major European producers – Eastern Sugar (UK/France), Nordzucker (Germany), SDA (France) and Agrana International (Austria) – are present. The sugar sector accounts for around 8.5 per cent of total food sector output and is also one of the main suppliers to other sub-sectors in the industry.

The beer sector has also attracted a lot of foreign investment. Two foreign companies, Heineken (Netherlands) and South African Breweries (SAB) are the two market leaders, followed by the local Topvar brewery. In 2000, Heineken continued its expansion by taking over the Gemer brewery in eastern Slovakia and announced a plan to invest US$ 2.3 million in the facilities in the next three years.

The dairy sector has also attracted investment lately, with the take-over of two major domestic producers by western investors in 2000. Bongrain (France), Europe's third largest dairy producer, acquired Liptovská mliekáreň, which produces around 50 per cent of Slovakia's cheese. Fromageries Bel, a prominent French cheese producer, bought 81 per cent of Zempmilk, Slovakia's largest soft-cheese producer that is located in Michalovce, eastern Slovakia. Rajo, the biggest milk producer in the country, is also owned by western investors, namely Austrian firm NOM AG.

Transport

The Slovak government has put the development of transport into the forefront of its strategy. In addition to the ongoing motorway extensions, it intends to re-structure and modernise the railway network and to bring much needed investment into the aviation sector by selling its stake in Slovak Airlines.

According to the EU Commission's latest report, Slovakia has made progress in alignment with the transport acquis, but still there is need for further advances. Slovakia is especially urged to strengthen the overall administrative capacity of the transport system, to establish independent bodies that oversee aviation safety and technical requirements and to improve the financial, managerial and technical standing of the railway system. Slovakia also benefits from the EU's ISPA programme that provides grants for infrastructure projects in the area of transport and environment. One project has already been selected for ISPA financing, namely the modernisation of the Bratislava-Trnava Rail Track with an allocation of € 38.5 million.

Air transport

The country has five airports that receive international flights, situated in the capital Bratislava, the second city Košice, Piešt'any, Sliač and Poprad, which is the gateway to Slovakia's main tourist area, the Tatra mountains. There are two main air carriers, Air Slovakia (established in 1992 and operating uninterruptedly since 1992 as a fully private company) and Slovak Airlines (SA), established in 1998. In 2000, the government announced that it intends to sell 34 per cent of its share in SA by the end of 2001.

Roads

The Slovak government has been concentrating its efforts on extending the motorway network. At present, 44 per cent (290 kilometres) of the planned 660 kilometre corridor motorways are completed and around 10 per cent are under construction. The country's mountainous terrain makes road transport difficult, especially concerning north-south links. At present a bridge over the Danube at Štúrovo, connecting Slovakia and Hungary, is being reconstructed.

Water transport

Slovakia has three ports on the Danube, at Bratislava, Komárno and Štúrovo. The Rhine-Main-Danube Canal gives these ports access to the Pan-European waterway system.

Railways

The railway system is the prime mode of transport for both passengers and goods. However, the railway continues to operate at a heavy loss and large amounts of investment capital are necessary for its modernisation. Currently, Slovakia's efforts are concentrated on measures aimed at gradually restructuring the Slovak railways. The European Commission also underlined the need for more work on the alignment to the *acquis* on railway transport, especially regarding access rights, licensing, allocation of capacity and infrastructure charges.

Financial sector

Restructuring and privatisation of the banking system progressed well in 2000. The government has taken important steps to recapitalise the sector and privatisation of the largest state-owned banks entered its final stage. The strengthening of banking and capital market regulations and harmonisation with EU standards, also advanced.

Banking sector

The new Banking Act, which came into force in October 1999, strengthened the supervisory role of the National Bank of Slovakia and improved access to information for potential investors. In addition, in November 2000 the government established a Financial Market Authority to supervise the country's capital market and insurance sector. Despite these advances, further efforts are needed to bring the legislative framework more fully in line with the *acquis*. Notably, Slovak banking rules on capital adequacy and consolidated supervision and accounting are not yet fully in line with EC requirements.

The Slovak banking sector includes 21 banks, two branches of foreign banks and nine representatives, although it is highly concentrated with three large banks dominating the market. These are Všeobecná úverová banka (VUB), Slovenská sporitel'ňa (SLSP) and Investičná a rozvojová banka (IRB). VUB and SLSP each account for just over 20 per cent of total assets and IRB holds around 6 per cent. Due to the practice in the past of extending loans on non-commercial terms, these banks became burdened by many non-performing assets. Since 1999, the government has been making serious efforts to restructure and privatise these entities. (See *Bank restructuring and privatisation* below.)

The private banks are mainly small and medium-sized institutions, some with considerable foreign involvement. One of the largest and most profitable in this category is Tatrabanka, founded in 1991 and owned by Austria's Raiffeisen Zentralbank (RZB). Tatrabanka is a leading bank in the information technology sector and has its own highly successful Internet banking arm known as Eliot. Tatrabanka has 62 branches since opening 12 new branches in the first half of 2000. The modernisation of Tatrabanka was helped by an EBRD subordinated loan provided in 1995.

The small-sized segment of the banking sector is undergoing consolidation. Several of these banks have already gone bankrupt, merged with larger banks or been bought by foreigners. The most recent foreign acquisitions include PKB, a municipality focused bank, which was bought by Dexia (France/Belgium) and Kommunal Kredit (Austria). In another deal, Italian group Unicredito bought 51.2 per cent of agribusiness oriented Pol'nobanka from Slovenská poist'ovňa, the largest insurance company, in April 2000. The EBRD has an equity stake in Pol'nobanka and contributed € 10 million to a € 33 million Grain Receipt Programme run by Pol'nobanka.

Bank reconstruction and privatisation

After years of insider dealing and soft lending in the mid-1990s the banking sector was burdened with the problem of insufficient loan reserves and capital for its high amount of non-performing loans. According to the OECD, the proportion of classified loans in the three big state-controlled banks had reached 35 per cent by 1998. In 1999, the government started the process of restructuring the balance sheets of the largest state-owned banks and initiated preparations for their privatisation. The government transferred SKK 74 billion (€ 1.7 billion) of bad loans, equivalent to almost 10 per cent of GDP, from the three large state-owned banks to the Consolidation Agency and the Consolidation Bank, and increased their capital by SKK 19 billion (€ 440 million). VUB was the largest beneficiary of the restructuring, as it was divested of classified loans worth about SKK 44.9 billion (€ 1 billion). SLSP's total classified loan transfer was SKK 22.8 billion (€ 500 million) and IRB's SKK 6.5 billion (€ 151 million). In the second half of 2000, the government transferred SKK 21.3 billion (€ 484 million) of classified loans from VUB and SKK 12.9 billion (€ 293 million) from SLSP to the Consolidation Agency. As a result of the measures taken, at the end of 2000 the state banks were able to meet the 8 per cent capital adequacy requirement and the share of bad loans in their loan portfolio was reduced to below 20 per cent.

Concerning privatisation, the sale of two large banks was completed in December 2000. In December 1999, the state-owned shares of Československá obchodná banka (ČSOB), a bank that was originally jointly owned by the Czech and Slovak government, was sold. The 24.2 per cent stake held by the state was sold to KBC Bank (Belgium), which had already acquired the Czech stake in June 1999, and the EBRD. SLSP was the second bank to be successfully privatised. In December 2000, it was announced that Erste Bank (Austria) had won the privatisation tender of SLSP. The purchase agreement was signed in January 2001. This move marks Erste Bank's latest expansion into central Europe following acquisitions in Croatia, Hungary and the Czech Republic. The purchase price was € 425 million.

The tender for the sale of VUB was launched in January 2001. VUB, like IRB, managed to return to profit in 2000 following restructuring. During 2000 it successfully expanded in the retail market. In September 2000, it held 20 per cent of total retail deposits and 98 per cent of the tiny mortgage market. To strengthen the bank in the run up to privatisation, the EBRD and the IFC acquired a 25 per cent stake in the first phase of privatisation. Additionally, the EBRD will provide a € 20 million SME credit line to VUB in order to support its lending operations in a sector not yet adequately served in the country and to improve its expertise in this kind of financing.

The tender for the privatisation of IRB was launched in summer 2000 and a decision will be made in July 2001. The IRB is the third largest bank with a balance sum of SKK 28.4 billion (€ 660 million). Between December 1997 and the end of 1999 the bank was under the forced administration of the National Bank of Slovakia, but its balance sheet has been largely cleared up over the last two years. The restructuring of the bank has proved successful, as in the first nine months of 2000, for the first time in many years, IRB made a profit of SKK 4.5 billion (€ 104 million). IRB holds deposits totalling almost SKK 9.8 billion, and has provided loans worth SKK 21.4 billion (€ 500 million) at present.

Non-bank financial institutions

Stock exchange

The government has indicated that improvements to the capital markets will be an important element of its structural reform programme. The strengthening of the regulatory environment and the actual and planned introduction of new companies are all expected to give a boost to the Bratislava Stock Exchange (BSE), which is still small and relatively underdeveloped, even by regional standards. Although there are more than 800 listed companies, the market is illiquid and local stock exchange capitalisation remains at 2.5 per cent of GDP.

The BSE organises securities trading on three markets: a listed market, a registered market and a free market. Companies whose shares or bonds are traded on the BSE listed market are obliged to publish their economic results once a quarter. Companies on the registered and free market should publish their economic results once every half-year.

Slovenský akciový index (SAX – Slovak Share Index) is the official share index of the BSE. It was launched in September 1993 with a starting value of 100. After it peaked in 1996 and 1997, recording values above 200, SAX fell below 100 at the time of the Russian crisis in 1998 and has maintained values of 80-90 since. Since 1996, the BSE quotes a bond index as well, the Slovenský dlhopisový index (SDX – Slovak Bond Index).

In 2000, the government made attempts to tighten supervision of the capital markets. A new stock exchange regulatory body was established and a new Act on Stock Exchange was adopted in September 2000, which foresees a number of improvements, including tightening up listing requirements, and introduces stricter requirements on the provision of information. In addition, improvements were made to the process of bond issuance with an amendment to the Act on Bonds in January 2000.

The introduction of more companies would also inject new life into the BSE, as analysts repeatedly claim that there are too few stocks available for trading. The ongoing bank privatisation, the planned sale of the largest insurance company, Slovenská poist’ovňa, and the planned pension reform should give a further boost to activities on the BSE in the near future.

Insurance

The insurance market is highly competitive and is undergoing liberalisation. The market developed rapidly in the late 1990s with the entry of foreign insurance companies such as AIG Life (US), Nationale-Nederlanden (Netherlands), Allianz (Germany), Wiener Städtische and Uniqua (both Austria). Life insurance has been the most dynamic segment, occupying around one third of the total market. The market is expected to grow further as Slovaks, although the highest insurance spenders in the region alongside the Hungarians, still spend 10 times less on insurance than people in the EU states. According to the Slovak Association of Insurers, total insurance market growth will be around 8-13 per cent in the period of 2000-04.

The government is in the process of liberalising the market. In April 2000, important changes were introduced by an amendment to the Insurance Act that brings the operation of the insurance market in Slovakia closer to EU standards. The new Act allows foreign insurers to open branches in Slovakia (formerly they had to operate through local subsidiaries) and allows Slovak entities to insure themselves abroad. In addition, the state's regulatory powers have been improved by the new legislation. Slovenská poist’ovňa still holds a monopoly in motor vehicle third-party liability insurance and employer's liability insurance. However, the legislation necessary for the liberalisation of the car insurance sector is scheduled to come into force at the beginning of 2002.

The Country Promotion Programme

thanks

Taipei China

The Taipei Technical Cooperation Fund

United Kingdom

The Know How Fund

Switzerland

The Swiss Technical Cooperation Fund

Canada

The Atlantic Council of Canada

Largest insurance companies in Slovakia (1999)

Name	Strategic partner	Market share (%)
Slovenská poisťovňa	none	44.2
Amslico AIG Life	AIG life (US)	16.6
Nationale-Nederlanden	Nationale-Nederlanden (Netherlands)	12.7
Kooperativa	Wiener Städtische (Austria)	5.3

Source: Slovak Association of Insurers

In September 2000, the government announced its intention to sell its stake in Slovenská poisťovňa to a single strategic insurer. The state insurer Slovenská poisťovňa is still in a dominant position, although its market share has been eroding significantly. The company has lost the most customers in the life insurance sector, as its share of the market dropped from an 83 per cent high in 1995 to a 44 per cent low in 2000.

In December 2000, the EBRD acquired a 23.5 per cent stake in TBI Holdings (TBIH), a Dutch company focusing on insurance, pensions and other non-bank financial activities in four eastern European countries (Bulgaria, Croatia, Romania and Slovakia). TBIH has a 90 per cent share in Slovak pension fund manager Tatry.

EBRD activities in the Slovak Republic

As at 31 December 2000, the European Bank for Reconstruction and Development (EBRD) had approved funding for 29 projects in the Slovak Republic for a total investment of € 636.2 million. Eight equity investments and 21 loans (some of them combined with equity investments to the same entities) are supporting private/competitive enterprises in telecommunications, aluminium, chemicals, agribusiness, small and medium-sized enterprises (SMEs), banking and finance, and construction of a multi-purpose complex. Three public infrastructure projects (with EBRD financing of € 89 million) are focusing on road improvements, telecommunications, and gas transit and distribution.

Technical cooperation programmes approved by the EBRD in the Slovak Republic are aimed at project preparation and support in the fields of environment, conversion of facilities from military use, a special restructuring programme, telecommunications, nuclear safety measures, railways, an aluminium smelter, banking, energy efficiency and regional development. This includes € 7.7 million from EC Phare, which the EBRD was instrumental in obtaining for the Slovak Post-Privatisation Fund.

EBRD strategy

The key priorities of the EBRD are outlined below.

In the **financial sector**, the EBRD will provide Phare SME loans to banks for on-lending to local SMEs and will provide equity financing to SMEs through private equity funds. Further focus will be on supporting the pension reform and completion of the insurance sector reform and privatisation. Creative strategies for the restructuring of the corporate sector, such as creation of a bankruptcy fund, will also be considered.

In the **corporate and industrial sectors**, the EBRD will promote restructuring and improved corporate governance in the private sector by providing equity investment or long-term debt financing. Most industrial projects that the Bank will consider are likely to involve foreign investors, either taking over or entering into joint ventures with existing companies. The Bank expects participation in industrial reconstruction to be in partnership with foreign strategic partners who are in a position to upgrade technology, open up new markets and increase productivity to levels where manufacturing can be internationally competitive.

In the **infrastructure and environmental sectors**, the EBRD will support the Slovak Republic's negotiations for EU membership by financing municipal and environmental infrastructure projects. There is substantial and urgent investment demand in the sector, not only to meet EU accession requirements but also to improve the efficiency and quality of service provision. Sectors provisionally identified as high priority are energy efficiency and railways, as well as municipal water, waste-water, solid waste and district heating projects.

The EBRD is also considering participation in the privatisation of the Slovak gas company. Support for infrastructure projects will be coordinated with the European Commission, the European Investment Bank and the World Bank.

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Approved projects, as at 31 December 2000
(excluding regional investment funds and multi-project facilities – in € million, exchange rates as at 31 December 2000)

Operation name	Sector	Project cost	EBRD finance	Type
Private				
Slovak Grain Receipt				
Programme – Framework	Agribusiness			Loan
Pol'nobanka		16.4	3.1	Loan
Pol'nobanka		20.5	10.2	Loan
Pol'nobanka		20.5	10.2	Loan
SPB Co-financing Facility –				
Framework	Agribusiness	0	0	Loan
Topolciansky		1.9	1.0	Loan
Mineralne Vody		1.7	0.8	Loan
Miva		1.4	0.5	Loan
CGC Termotech Esco	Energy distribution	12.5	3.1	Loan
			0.3	Equity
L&G ESCO Slovakia	Energy	6.2	1.7	Loan
			0.5	Equity
FGG Municipal Services MPF	Energy distribution	10.5	3.1	Loan
Eurotel Bratislava Spol s.r.o	Telecommunications	40.8	8.6	Loan
Globtel AS	Telecommunications	263.3	26.9	Equity
VUB Pre-privatisation	Finance	90.0	70.0	Equity
			20.0	Loan
Istrobanka Credit Line	Finance	15.3	5.8	Loan
PBK Equity Investment	Finance	7.7	7.7	Equity
PBK General Purpose & Energy Efficiency	Finance	21.6	11.8	Loan
Pol'nobanka (formerly SPB)	Finance	13.6	3.1	Equity
Prva Komunalna Banka a.s.	Finance	10.2	10.2	Loan
Slovak Post Privatisation Fund	Finance	25.8	7.8	Equity
8 sub-projects		20.2	16.3	Equity
			2.1	Loan
Slovenska Pol'nohospodarska Banka (SPB)	Finance	4.0	4.7	Equity
Slovenska Pol'nohospodarska Banka (SPB)	Finance	9.0	1.9	Equity
Tatra Bank credit line	Finance	15.3	15.3	Loan
Tatra Banka Subordinated Debt	Finance	12.8	12.8	Loan
Regional Waste Disposal Sites	Municipal infrastructure	2.6	1.0	Loan
ZSNP Tranche A	Aluminium production	43.0	41.7	Loan
ZSNP Slovalco Tranches B&C	Aluminium production	493.8	118.2	Loan
			11.8	Equity
Sloveca	Chemicals/detergents	14.8	7.7	Loan
Slovnaft a.s	Petrol refinery	46.6	21.5	Loan
Slovnaft a.s. Equity	Petrol refinery	576.0	44.2	Equity

continued

Approved projects, as at 31 December 2000
(excluding regional investment funds and multi-project facilities – in € million, exchange rates as at 31 December 2000) – continued

Operation name	Sector	Project cost	EBRD finance	Type
Bucina a.s.	Wood product manufacturing	14.6	14.6	Loan
Polus Center	Retail Construction	72.9	27.0	Loan
Total private		**1,905.5**	**547.2**	
Public				
Slovak Telecommunications	Telecommunications	272.0	44.0	Loan
International Road Corridor	Transportation	41.6	15.0	Loan
SPP Bond Issue	Natural resources	150.0	30.0	Loan
Total public		**463.6**	**89.0**	
Approved projects total		**2,369.1**	**636.2**	
of which private				86%
of which public				14%